RESEARCH

EUROPEAN QUARTERLY

COMMERCIAL PROPERTY OUTLOOK

Q2 2014

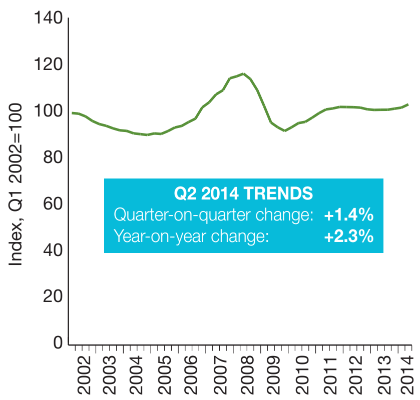
OCCUPIER TRENDS | INVESTMENT TRENDS | MARKET INDICATORS

EUROPEAN OUTLOOK

Despite faltering Eurozone economic growth, the positive momentum of the commercial property market is expected to be maintained in H2 2014, albeit investment activity will continue to run ahead of the occupier market.

FIGURE 1

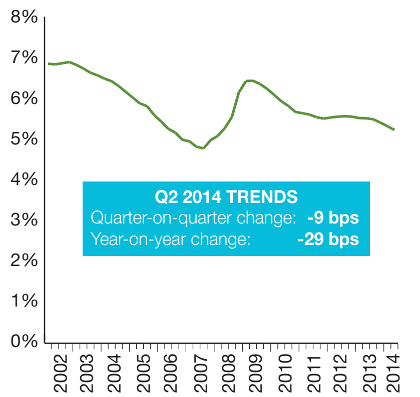
European prime office rental index



Source: Knight Frank Research

FIGURE 2

European weighted average prime office yield



Source: Knight Frank Research

The Eurozone economic recovery stuttered in Q2, with the single currency area recording zero growth. This was in large part due to the weakness of its three largest economies; Germany and Italy both contracted by -0.2%, while France stagnated. More encouraging growth figures were seen elsewhere, with Spain, Portugal and the Netherlands among the strongest performers.

The poor performance of Germany in Q2 was, in large part, a correction following particularly strong growth of 0.7% in Q1. Purchasing Managers' Index (PMI) data suggests that the German economy is on course to rebound in Q3. This should help the Eurozone to avoid re-entering recession, although growth is likely to remain uneven and there are downside risks posed by the threat of deflation and geopolitical tensions in the east.

Notwithstanding the hesitant economic recovery, confidence that the worst of the Eurozone debt crisis is over has helped to encourage increasing investment activity over the last 18 months. Q2 2014 was an exceptionally strong quarter; boosted by several very large portfolio deals, European commercial property investment volumes reached €42.0 billion, up 44.4% on the same quarter of 2013.

There is a growing wall of capital targeting European property, which has been created both by established investors increasing their allocations to real estate, and by new market entrants from Asia, the Middle East and North America. The strength of the competition for prime assets in London, Paris and the Tier 1 German cities is pushing increased volumes of capital towards smaller, but higher yielding, markets such as the Benelux and the recovering Southern European countries.

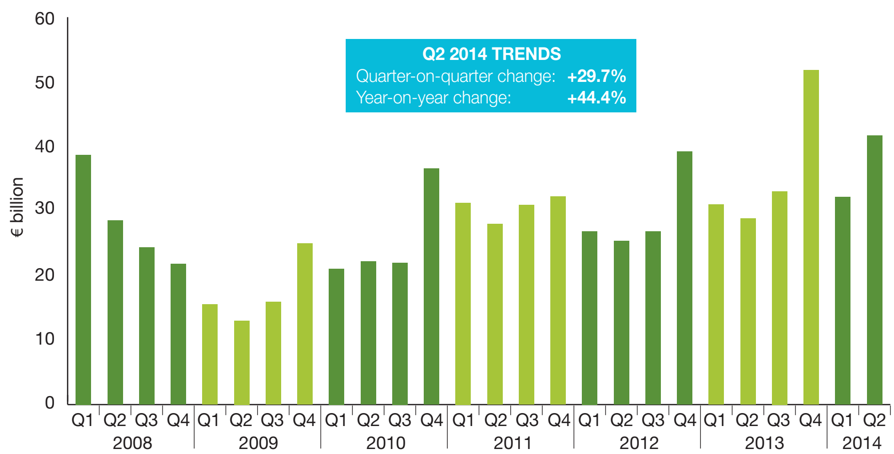
With other asset classes offering historically low returns, Knight Frank anticipates that European real estate will continue to attract increased capital from investors seeking diversification or higher yields. As a result, European investment volumes for 2014 are forecast to comfortably exceed 2013, which itself was the best year since 2007.

While the investment market is seeing a broad-based increase in activity, European occupier markets are experiencing a more modest and varied recovery. A significant bright spot, however, has been the revival of the Paris office market, which appears to have rebounded from a slow 2013, with take-up in Q2 2014 reaching the highest quarterly total since Q3 2012.

European prime office rental growth remains fairly subdued, although rental increases were recorded in London (West End) and Munich in Q2. Prime rents also rose in Dublin, which has seen exceptionally strong growth over the last 12 months, while Madrid office rents increased for the first time in five years. Prime rental growth is expected to remain modest over the rest of 2014, although continued pockets of growth are anticipated in both strong core cities and recovering peripheral markets.

FIGURE 3

European commercial property investment volumes



Source: Knight Frank Research / Real Capital Analytics

MARKET HIGHLIGHTS

AMSTERDAM (1)
Strong interest from cross-border purchasers, particularly from Germany, has boosted the Amsterdam investment market. Deka's €200 million acquisition of The Edge office development in Q2 was the latest of a number of recent landmark deals in the South Axis.

BRUSSELS (2)
Q2 saw the largest single-asset investment deal ever in Brussels, with the €475 million purchase of the North Galaxy office towers by a joint venture involving the Danish pension fund ATP and AXA.

DUBLIN (3)
Prime office rents have risen by 33% over the last 12 months, and now stand at €40 per sq ft per annum (€431 per sq m per annum).

FRANKFURT (4)
Frankfurt office market activity was subdued during H1 2014, with a lack of large-scale transactions causing take-up to fall to c.154,000 sq m, down 19% compared with H1 2013.

LONDON (5)
Over the last twelve months, prime office rents have risen by 9% in the City and by 8% in the West End. Further rental growth is forecast by the year-end.

MADRID (6)
International investors continue to target the recovering Madrid market. In Q2, PSP Investments, the Canadian pension fund manager, was part of a consortium that bought the Castellana 200 office and retail complex for c.€140 million.

MILAN (7)
Following its acquisition of a 40% stake in the Porta Nuova project last year, the Qatar Investment Authority has reportedly purchased Credit Suisse's Italian HQ in Milan for c.€105 million.

MOSCOW (8)
Occupier market activity slowed in Moscow during H1 2014, with office take-up reaching c.220,000 sq m, 29% down on H1 2013. With large amounts of new supply coming to the market and Grade A rents under downward pressure, the market is currently balanced in the favour of tenants.

PARIS (9)
Paris office take-up reached c.1.13 million sq m in H1, up 24% on the same period of 2013. Activity in Q2 was boosted by three transactions of over 30,000 sq m, involving KPMG (40,468 sq m), L'Oreal (38,000 sq m) and Solocal (34,000 sq m).

WARSAW (10)
As a result of high levels of development activity, Warsaw's office vacancy rate continues to rise, reaching 15.1% in Q2.

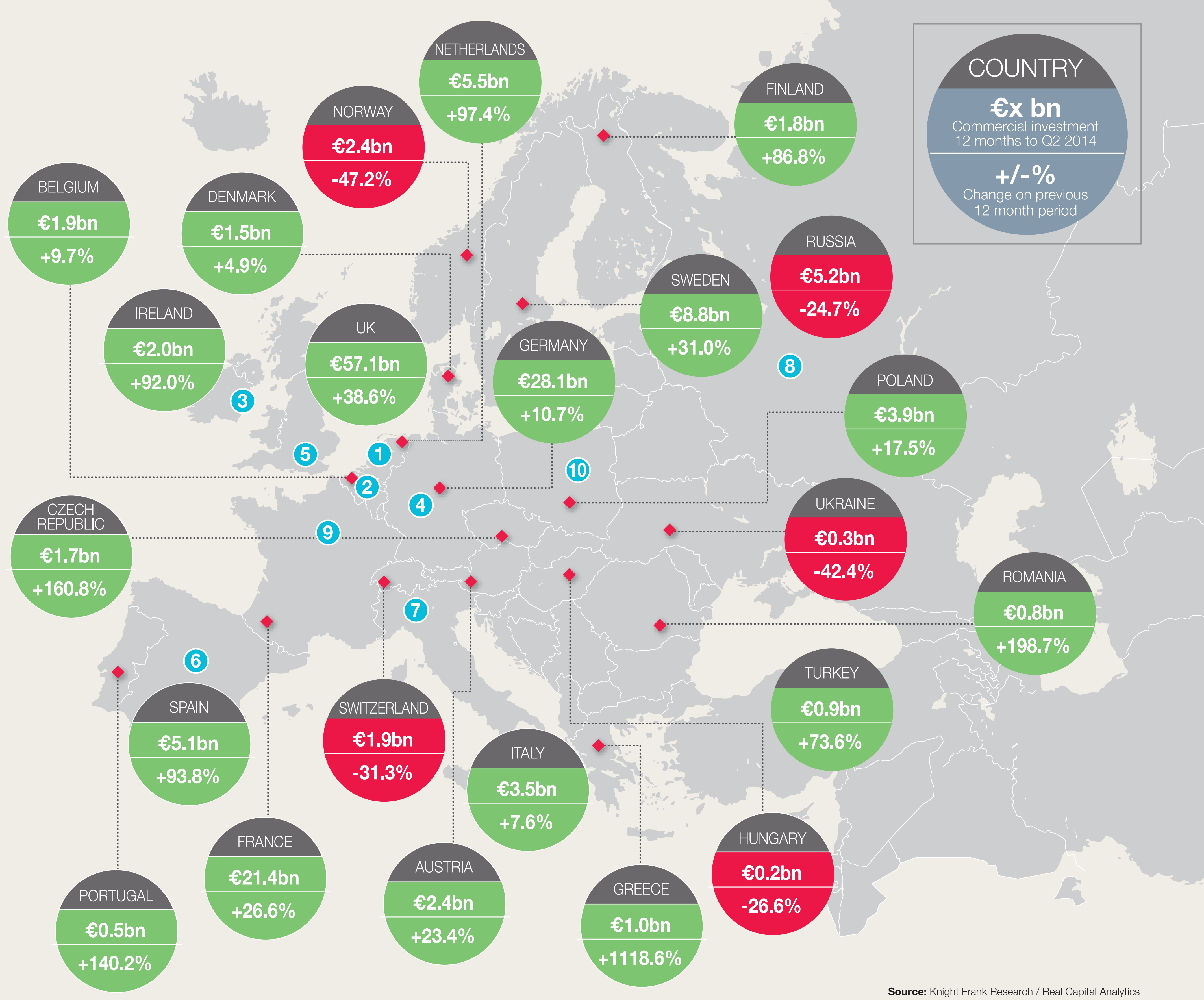
FIGURE 4 **How much prime office space does €100 million buy? (sq m)**

LONDON (WEST END)	2,737
PARIS	5,333
LONDON (CITY)	5,583
ZURICH	6,078
STOCKHOLM	9,240
OSLO	10,096
FRANKFURT	10,307
MUNICH	10,628
DUBLIN	11,601
MILAN	11,667
MOSCOW	11,814
HELSINKI	13,441
MADRID	15,805
VIENNA	16,156
BERLIN	17,210
AMSTERDAM	17,353
COPENHAGEN	20,213
WARSAW	20,408
BRUSSELS	21,053
PRAGUE	26,709
BUDAPEST	31,250
LISBON	32,658
BUCHAREST	38,194

Source: Knight Frank Research

The above figures are derived from hypothetical prime capital values, based on current prime rents and yields in each of the cities listed.

FIGURE 5
European commercial property investment volumes, 12 months to Q2 2014



Source: Knight Frank Research / Real Capital Analytics

EUROPEAN MARKET INDICATORS

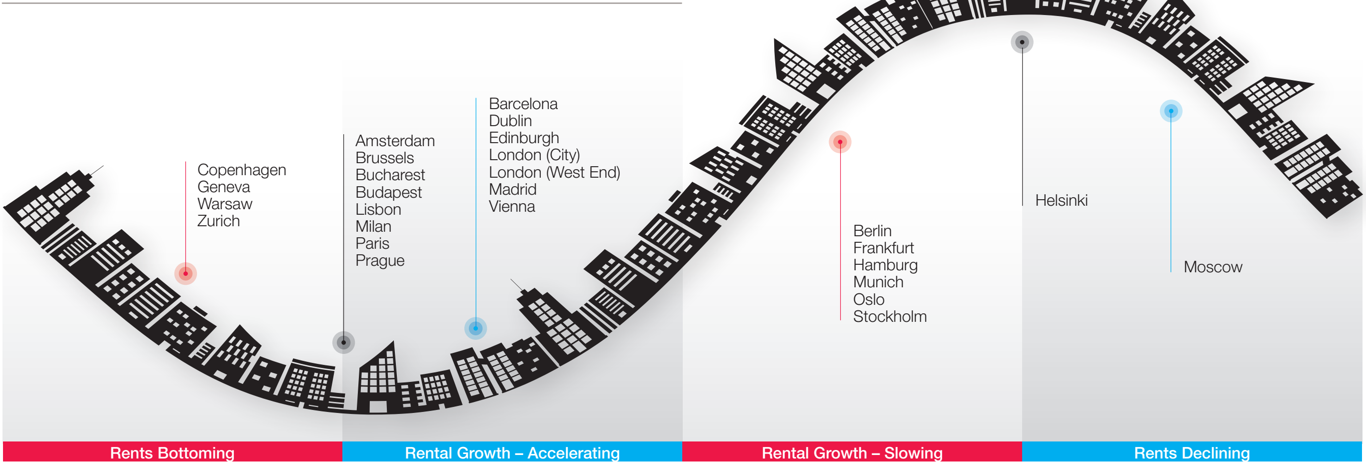
Prime rents remain stable across most European commercial property markets, but prime yields continue to come under more widespread downward pressure.

Commercial property prime rents and yields

City	Offices Prime rents (€/sq m/yr)	Offices Prime yields (%)	Logistics Prime rents (€/sq m/yr)	Logistics Prime yields (%)	Shopping centres Prime rents (€/sq m/yr)	Shopping centres Prime yields (%)	Retail warehousing Prime rents (€/sq m/yr)	Retail warehousing Prime yields (%)
Amsterdam	340 ▶	5.90 ▼	85 ▶	7.00 ▼	1,000 ▶	5.50 ▶	135 ▶	6.75 ▶
Barcelona	192 ▲	6.00 ▼	54 ▲	8.25 ▶	552 ▶	7.00 ▼	120 ▶	7.50 ▶
Berlin	276 ▶	4.75 ▼	66 ▶	6.50 ▼	1,380 ▶	4.75 ▶	150 ▶	6.50 ▶
Brussels	285 ▶	6.00 ▶	45 ▶	7.00 ▼	1,400 ▶	5.00 ▶	165 ▼	6.25 ▶
Bucharest	216 ▶	8.25 ▶	45 ▶	11.00 ▶	504 ▶	8.50 ▼	96 ▶	9.50 ▼
Budapest	240 ▶	7.50 ▶	54 ▶	9.00 ▶	960 ▶	7.00 ▶	90 ▶	8.00 ▶
Copenhagen	235 ▶	4.75 ▶	67 ▶	7.00 ▼	697 ▶	5.75 ▶	157 ▶	6.75 ▶
Dublin	431 ▲	5.00 ▼	65 ▶	7.75 ▼	2,520* ▶	6.50 ▼	200 ▲	7.75 ▼
Edinburgh	376 ▶	5.50 ▼	87 ▶	7.00 ▶	2,284* ▶	5.75 ▶	378 ▶	6.50 ▶
Frankfurt	456 ▲	4.70 ▼	80 ▶	6.25 ▼	1,560 ▶	4.75 ▼	168 ▶	6.50 ▼
Geneva	658 ▶	4.00 ▶	165 ▶	6.00 ▶	1,100 ▶	4.75 ▶	200 ▶	5.50 ▶
Hamburg	300 ▶	4.50 ▼	68 ▶	6.25 ▼	1,620 ▶	4.75 ▶	150 ▶	6.50 ▼
Helsinki	372 ▶	5.00 ▶	120 ▶	7.25 ▶	1,200 ▶	5.25 ▶	145 ▶	6.50 ▶
Lisbon	222 ▶	7.25 ▼	48 ▼	9.25 ▶	900 ▶	7.75 ▼	96 ▼	9.50 ▶
London	1,370 (WE) ▲ 806 (C) ▲	3.75 (WE) ▶ 4.50 (C) ▶	168 ▶	5.25 ▼	5,928* ▶	4.75 ▼	527 ▶	5.25 ▶
Madrid	348 ▲	5.50 ▼	57 ▲	8.00 ▼	528 ▲	6.50 ▼	120 ▶	7.50 ▶
Milan	450 ▶	5.25 ▼	50 ▶	8.25 ▶	850 ▶	6.50 ▶	300 ▶	7.50 ▶
Moscow	783 ▼	9.25 ▲	98 ▶	11.50 ▲	3,200 ▶	9.75 ▲	N/A	N/A
Munich	414 ▲	4.40 ▼	82 ▲	6.25 ▼	1,860 ▲	4.50 ▶	172 ▲	6.50 ▶
Oslo	520 ▶	5.25 ▶	137 ▶	6.50 ▶	1,000 ▶	5.25 ▶	150 ▶	6.25 ▶
Paris	750 ▶	4.00 ▶	55 ▶	7.00 ▼	2,000 ▲	4.50 ▶	200 ▲	5.50 ▶
Prague	234 ▶	6.25 ▶	51 ▶	7.50 ▼	840 ▶	6.00 ▶	120 ▶	8.00 ▶
Stockholm	487 ▶	4.50 ▶	114 ▶	6.25 ▼	800 ▶	5.00 ▶	227 ▶	6.00 ▶
Vienna	294 ▶	4.75 ▼	72 ▶	7.25 ▶	1,320 ▲	5.25 ▼	168 ▶	6.00 ▼
Warsaw	294 ▶	6.00 ▶	66 ▶	7.50 ▼	1,200 ▶	6.00 ▶	132 ▶	7.50 ▶
Zurich	617 ▶	3.75 ▶	148 ▶	6.00 ▶	1,200 ▶	4.75 ▶	220 ▶	5.50 ▶

Indicative prime yields, as quoted locally, based upon a hypothetical Grade A unit. Office rents are for prime city area Grade A space, 2,000 sq m. Shopping Centre rents are based on prime covered shopping malls, quoted on best position, 100 sq m units. Retail Warehouse rents are for units of 1-5,000 sq m located in purpose built parks. Typical Retail Warehouse schemes vary between countries. Logistics rents are for prime industrial space of units over 5,000 sq m. The data above is provided for general reference purposes only. Local market conditions will vary. *Zoned/weighted figure. Arrows provide a broad indication of recent movements and the short-term outlook for prime rents and yields. London office data is quoted for the West End (WE) and City (C) submarkets.

FIGURE 6
Prime office rental cycle



The above diagram is intended to provide a comparative guide to the current positions of European prime office markets in their rental cycles. Markets will move through their cycles at different speeds and, sometimes, in different directions. The positions indicated in the diagram do not constitute formal forecasts of future rental trends.

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